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C O N F I D E N T I A L SECTION 01 OF 02 MINSK 001019

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TAGS: [EPET](#) [ECON](#) [PREL](#) [ENRG](#) [ETRD](#) [PGOV](#) [PINR](#) [BO](#)
SUBJECT: UNION STATE STAGNATES ALONG WITH GAS NEGOTIATIONS

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Classified By: Charge Dereck Hogan for reasons 1.4 (b) and (d).

11. (C) Summary. Despite public statements to the contrary, and without knowing the content of the "Constitutional Act," Russia and Belarus still appear far from completing an agreement on a Union State. Before seriously negotiating on the Union State the two still must resolve issues that re-emerged in the aftermath of the fraudulent March elections -- gas prices and the ownership of Belarus' national gas pipeline company Beltransgaz. Any agreement on gas appears unlikely before December. While anything is possible, Belarusian rhetoric on the possibility of a joint referendum may be part of Lukashenko's public relations campaign to demonstrate his ability to prevent Russia from taking more drastic measures to achieve its perceived political and economic interests in Belarus. That said, our contacts familiar with the negotiations between Belarus and Russia believe Lukashenko will have to accept moderately higher gas prices and perhaps the transfer of a minority share of Beltransgaz to Gazprom. End summary.

Union State Rhetoric Kicks into High Gear

12. (SBU) After Lukashenko's return from the August Eurasian Economic Community (EURASEC) heads of state meeting in Sochi, Chair of the International Affairs and National Security Committee of the Upper House of Parliament Nikolay Cherginets told press a draft Constitutional Act for a Belarusian-Russian Union State was "99 percent" ready. Also, local press picked up a story from the Russian paper Zhizn claiming that the Kremlin was working on an order to set a referendum before the end of the year.

But Real Preparations Apparently Going Nowhere

13. (C) Cherginets revealed the likely true state of negotiations when he admitted the sides still did not agree on the composition of the executive branch of the would-be Union State. Even on the relatively less complicated task of launching a single currency, which is called for under existing drafts of the Union State constitution, the GOB is in no hurry. Vladimir Novik, Deputy Chairman of Belarusbank, recently told us no one at the bank had received any instructions to even consider the implications of currency unification.

14. (C) Contrary to press reports, none of our contacts familiar with Union State negotiations suggested Lukashenko is genuinely motivated to move forward on the union at this time. With his popularity and authority weaker than Putin's

in Russia, any union would serve only to further diminish the Belarusian dictator's standing. Valery Karbalevich, an analyst with the Strategy think tank, suggested that Lukashenko might have agreed to a proposal from Putin on a joint referendum in return for concessions on gas prices and the ownership of Beltransgaz. However, even if such an agreement was established, Karbalevich stressed that Lukashenko would not actually accept a referendum result in favor of a Union State constitution.

Gas Crowds Out Other Issues Till December

15. (C) The grain of truth in this dubious scenario is that Lukashenko is more focused on the successful resolution of gas prices and control over Beltransgaz than on implementation of the Union State constitution. Most analysts remain convinced Belarus is in no hurry to set a final price for gas or Beltransgaz. On the sale of Beltransgaz, Lukashenko will likely refuse to budge, claiming to Russia it is politically impossible for him to allow foreign ownership of his country's flagship enterprise after his repeated public statements that it was vital that Belarus maintain control of the pipeline. Even absent objective political concerns, it is doubtful Lukashenko would want to make a deal that included giving up control of Beltransgaz. Karbalevich noted initially Lukashenko refused Gazprom's overtures to purchase Beltransgaz because a deal would have conflicted with the dictator's psychological need for power. Similarly, Aleksandr Potupa, President of the Belarusian Association of Entrepreneurs, said Lukashenko's obsession with control, including over business, borders on a psychiatric condition.

16. (C) The Dutch bank ABN Amro will complete its appraisal of Beltransgaz in October, when Putin is expected to be in Minsk for a CIS heads of state summit. It is unlikely Lukashenko

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and Putin would be able to seal a deal at that time, however. Media expect a USD 2.5 billion difference between ABN Amro's minimum and maximum appraisal values of Beltransgaz. Sergey Zhbanov, the senior economic correspondent with the independent newspaper Belgazeta, told us it would be a big mistake to assume the two sides would settle on a sales price in the middle, as each side wants to hold out. Economist and opposition political figure Yaroslav Romanchuk also indicated the negotiations would drag out until at least the end of the year.

Lukashenko Will Have to Give Up Something

17. (C) However, our interlocutors could not foresee a clear way out for Lukashenko. Russia seems intent on extracting something costly from the Belarusian ruler, most likely in the economic sphere. The Kremlin knows just as much as the Belarusian regime that Lukashenko's relatively strong domestic support hinges on continued economic growth to prop up rising wages and steady pensions. Cheap gas, although not actually as important as cheap oil, helps drive the Belarusian economy, and thus any significant growth in gas prices will dampen economic growth. None of the dozen economists we spoke with doubted some rise in prices was likely. Those close to the government were most confident the economy could still grow, albeit more slowly if gas prices increased by about seventy percent from USD 47 per thousand cubic meters to USD 80. Aleksandr Matyas, the head of a research institute affiliated with the Belarusian Ministry of Economics, told us plans had already been drawn up to deal with an increase in gas prices if need be. Zhbanov suggested Lukashenko might accept an offer for Gazprom to purchase less than fifty percent of Beltransgaz if that was what it took to ensure gas at an affordable price.

18. (C) Lukashenko will not likely agree to a referendum on a Union State while he remains weaker than his Russian counterpart in Russia. Although Lukashenko's public support ratings are considerably higher than those of Putin in Belarus, the Belarusian leader has shown no interest in playing second fiddle in a Union State. Lukashenko would be able to accept a bargain including modest gas price increases and the sale of a minority stake in Beltransgaz. This will delay later negotiations on a fifty-percent stake in Beltransgaz to a future date when Lukashenko can hope the Russians are preoccupied with their own elections. Moreover, as long as he maintains his image as someone who can negotiate with Russia, perennially extending Belarus' dependence on cheap Russian gas serves to heighten some Belarusians' aversion to radical democratic change.
Hogan